

Insight: Litigation

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Turkcell Litigation – Another Victory for Cukurova

Privy Council confirms the terms for Cukurova to recover its interest in Turkcell

The Privy Council today delivered another crucial ruling in favour of White & Case's client Cukurova, in its six-year battle to recover its controlling interest in Turkcell (Turkey's largest mobile phone operator). The effect of its decision is that Cukurova will have to pay approximately \$1.5 billion to reacquire its shareholding, less than half the amount its opponents, Russia's Alfa, had claimed was payable.

In January, the Privy Council found Cukurova had an equitable right to redeem the shares, which Alfa had appropriated under the terms of a \$1.352 billion facility (see our previous [Client Alert](#) on the case).

The Privy Council has now set the terms for the redemption (essentially, the basis for and amount of interest payable). In doing so, it was unanimous on the financial consequences of Alfa's rejection of a prompt tender by Cukurova, in 2007, of the full amount then due. It ruled that (1) interest was not payable for the three years Cukurova held these funds in an account available to repay Alfa; and (2) after that period, interest was payable at the ordinary contractual rate, rather than the contractual default rate (as Alfa had contended).

Yet the decision leaves some uncertainty for lenders looking to exercise a contractual right to appropriate collateral to satisfy a debt. The Privy Council was divided on the scope of its equitable discretion to grant relief against appropriation. In a split decision on reasoning, the minority considered relief could only be granted on the terms of the underlying loan. However, the majority considered that, while the underlying contract was of obvious significance, in "exceptional circumstances" courts had a broader discretion to set the terms on which relief should be granted.

Background

In late 2005, as security for a \$1.352 billion loan facility from Alfa Telecom Turkey Limited ("Alfa"), Cukurova Finance International Limited ("CFI", a BVI-incorporated company) and Cukurova Holding A.S. (together, "Cukurova") charged to Alfa (also incorporated in the BVI) shares which conferred a controlling interest in Turkcell.

The security documents (governed by English law) granted Alfa a power of appropriation, a novel remedy introduced by the Financial Collateral Arrangements (No. 2) Regulations 2003 and now widely incorporated into English law security documentation. The Regulations allow parties to agree that, where security granted under a loan becomes enforceable, the lender can appropriate the security without a court order (though it must account to the borrower for any excess in the value of the security over the outstanding debt).

Following Alfa's appropriation of the charged shares in April 2007, Cukurova promptly tendered over \$1.4 billion to Alfa in full repayment of the loan (including accrued interest). Alfa refused to accept the tender. Nevertheless, Cukurova then held the full amount on account ready to repay Alfa for three years.



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In January 2013, the Privy Council ruled that Cukurova had an equitable right to redeem the charged shares which Alfa had appropriated. But it required a further hearing on the precise terms for the redemption – in other words, how much a borrower who has been afforded the right to redeem its security must pay a lender as compensation for having been kept out of the money since the default.

Decision

Alfa's primary argument before the Privy Council was that the terms of the loan remained in force, meaning Cukurova should be required to pay default interest on the outstanding debt for the entire period since the initial default. The Court's only equitable discretion, on Alfa's case, was to extend the time Cukurova had to repay principal and interest. If correct, the interest now payable to redeem the shares would significantly have exceeded the underlying principal.

Cukurova countered that the contractual provisions of the loan no longer applied, since appropriation had discharged the debt due. Thus, the Court had a broad discretion to determine the conditions for relief and could consider factors other than the contract terms, such as the fact that (1) Alfa's appropriation had been intended to prevent repayment; and (2) Cukurova's prompt tender of repayment after appropriation had been rejected by Alfa. On this basis, Cukurova argued that the Privy Council should award interest at a commercial rate intended to compensate Alfa for the loss of the use of its capital, not the default rate applicable under the loan.

The majority (in a judgment given by Lord Mance) accepted Cukurova's argument that appropriation discharged the due debt. As a rule, it accepted that relief against appropriation could only be granted on the basis of contractual terms. But it did not accept that this rule was inflexible. In exceptional circumstances, where there were "strong countervailing considerations of equity or unconscionability," the majority found it had a broader discretion to determine terms for redemption. In Cukurova's case, the majority found it would be unconscionable (1) to treat the loan as outstanding for the period Cukurova had held funds in an account ready to repay Alfa; and (2) after that period, to hold Cukurova liable to pay default interest after it had tendered the full sum repayable.

Though unanimous on the result, the Court disagreed on the reasoning. The minority (Lords Neuberger and Sumption) did not accept that appropriation discharged the due debt. They considered that the contractual terms must be treated as continuing and must determine the terms on which a right to redeem could be exercised. Lord Neuberger considered the majority decision "a fundamental misunderstanding of the role of equity in the context of commercial arrangements." Lord Sumption was more strident. Stating that "[i]t cannot be assumed that so radical a break with basic principle will be accepted in other ... jurisdictions," he looked to limit the impact of the majority's decision on English (and other common law) courts.

Nonetheless, the minority also found that no interest was payable for the period Cukurova held the sums tendered on deposit. It relied on decisions dating back 350 years to support the principle (also approved by the majority) that refusal of a valid tender by a lender with a mortgage stopped interest on that loan from running, providing the borrower set aside the sums due to the lender (as Cukurova had for three years).

Comment

Notwithstanding this decision, there remains a degree of uncertainty for lenders. The majority was at pains to emphasise that granting relief in equity which departs from the underlying contractual terms was permissible only in "exceptional circumstances." Yet this is unlikely to dissuade borrowers from arguing that their circumstances fit within this narrow exception. Lenders meanwhile cannot be certain – if the majority's reasoning is followed – that the contractual protections which they have agreed will apply.

It remains to be seen which approach the English courts will prefer. Although the decision of the Privy Council does not bind the English courts, the reasoning of a court comprising five Supreme Court judges would ordinarily be highly persuasive. Yet, in view of the minority's strong dissents, the English courts could decide either way. Further litigation will be required before lenders can exercise the power of appropriation with confidence that, if a right of redemption is granted, English courts will necessarily uphold the rest of their contractual bargain.

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